

2006 Finance Law Changes

Brenna Erford

NCGA Fiscal Research Division

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Budget Outlook

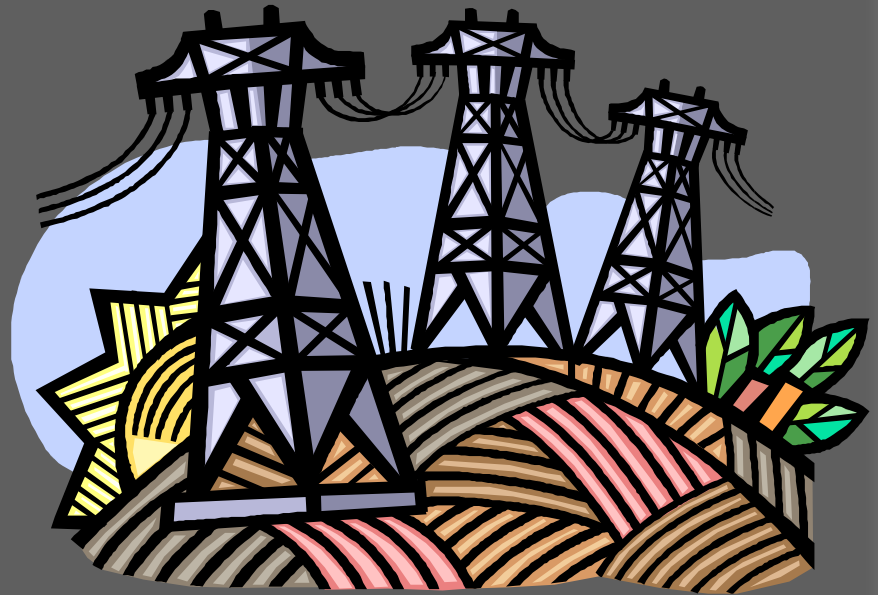
- 2005-06 revenue surplus: \$1.06 billion
- Baseline revenue growth was 11.8% versus 5.3% forecast
- About 37% of revenue surplus was counted as one-time or nonrecurring
- Baseline growth rate forecast for 2006-07 is 3.3%
- Substantial structural budget gap anticipated for 2007-08 fiscal year due to reliance on one-time resources for operating budget

2006 General Assembly Actions

- Sales Tax Changes
- Income Tax Changes
- Motor Fuel Tax Changes
- Credits & Incentives
- Franchise Tax Changes
- Property Tax Changes

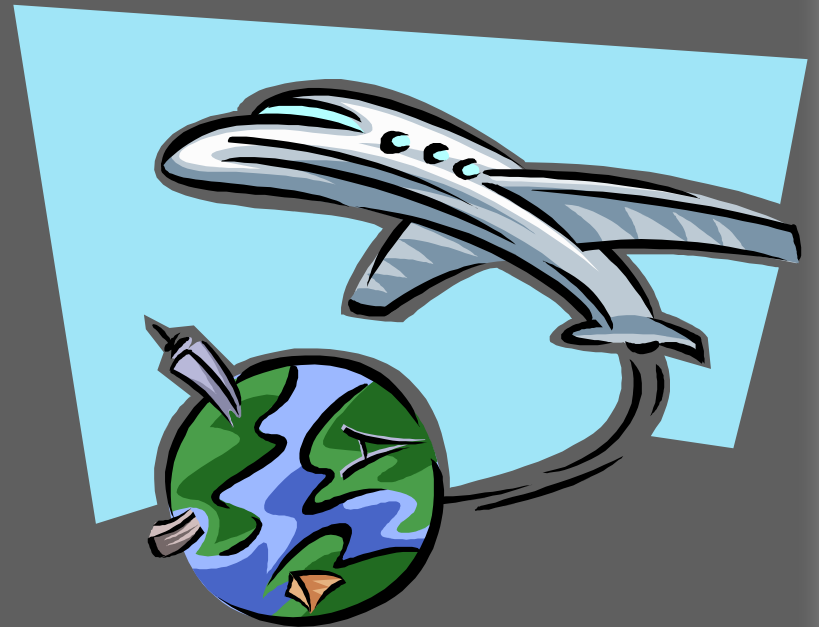
Sales Tax Changes - Rates

- State sales tax rate reduced from 4.5% to 4.25% effective December 1, 2006
 - Sunset for remaining ¼ cent sales tax remains July 1, 2007
- Sales tax rate for electricity sold to manufacturers reduced from 2.83% to 2.6% effective July 1, 2007



Sales Tax Changes - Refunds

- Aviation fuel refund extended through January 1, 2009, for motorsports & interstate passenger carriers
- 50% refund for motorsports racing teams on purchase of tangible personal property
- LEAs can apply for refund of local sales tax



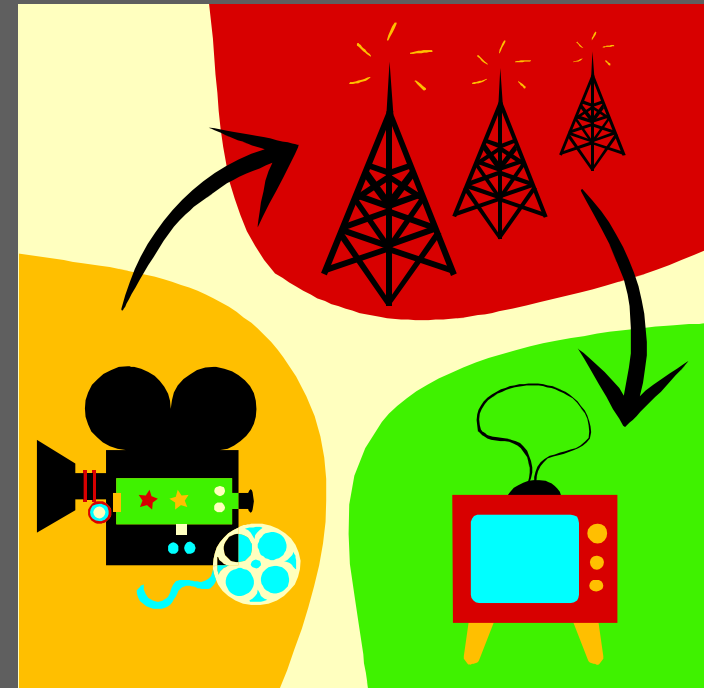
Sales Tax Changes - Exemptions



- Railroad cars leased by interstate carriers
- Electricity sold to Internet data centers
- Logging machinery
- R&D equipment (now subject to 1% privilege tax with \$80 cap per item)

Sales Tax Changes – Video Services

- All providers taxed at general rate
- No more local cable franchise fees
- State tax credit for franchise fees paid eliminated
- Share of State sales tax given to local governments
- Effective January 1, 2007



Streamlined Sales Tax Changes

■ New definitions

- Telecommunications services
- Ancillary service
- Prepaid wireless calling

- New sales tax payment schedule for semi-monthly filers
 - Affects largest NC retailers
- Eliminated provisions regarding small underpayments

Income Tax Changes

- Upper 8.25% tax bracket reduced to 8%
 - Effective January 1, 2007
 - Sunset for remaining ¼ cent remains January 1, 2008
- Extend real property donation tax credit
 - 2009 sunset
- 529 college savings plan deduction
 - \$750 for single filers, \$1,500 for joint in 2007; \$2,000 for single, \$4,000 for joint starting in 2008



Income Tax Changes

■ Additional joint filing option

- Married joint filers with one partner living in another state and earning no NC income may file joint NC return

■ Expansion of royalty reporting option

■ S Corp. Income Tax Adjustments

■ Conformed to IRC changes

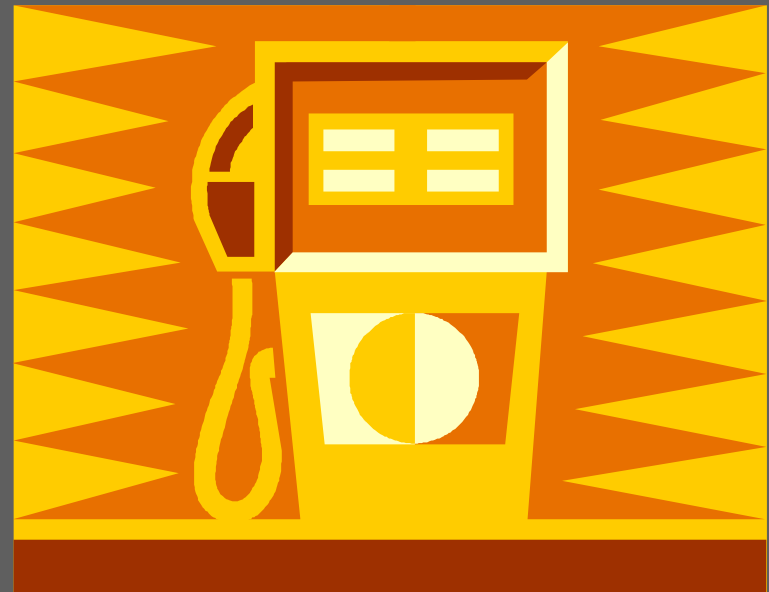
- Credit for child care
- Energy Act changes

■ Credits for alternative fuel investment & production

- Expanded credit for investment in alt. fuel production facilities
- New credit for biodiesel production

Motor Fuel Tax Changes

- Variable component of State tax on motor fuel capped at 12.4 cents per gallon
 - Effective July 1, 2006 through June 30, 2007



Credits & Incentives

■ Small Business Health Insurance Tax Credit

- Credit equal to 100% of employer's cost of providing benefits up to \$250 per employee
- Effective January 1, 2007
- Limited to 50% of taxpayers' income tax liability
- Credit does not apply to workers making $>\$40,000$
- 2009 sunset



Credits & Incentives

■ Bill Lee Act Changes

Changes in S.B. 1741

- **Expand Definition of Development Zone** (Section 24.5)
- **Wage Standard – Certain Manufacturers** (Section 24.14)
- **Agrarian Growth Zones** (Section 24.16)
 - Zone located wholly in a county
 - No city with population >10,000
 - All census tracts & block groups have poverty level of >20%
 - Area of zone does not exceed 5% of county

Changes in H.B. 2170

- **Replaces 1996 Act with more narrowly focused job creation & investment credits**
- **Substitutes three economic development tiers for five**
 - 40 counties in Tier 1
 - 40 counties in Tier 2
 - 20 counties in Tier 3
- **Summary table of changes is included in meeting documents**

Credits & Incentives

■ Mill Rehabilitation Tax Credit

- Increased credit for historic rehabilitations of qualified properties located in distressed economic tier counties

■ Film Incentive Changes

- Eliminates expense base add-back for film industry credit created in 2005

■ Oyster Shell Tax Credit

- \$1.00 per bushel donated to DENR



Franchise Tax Changes

■ Franchise Tax Loophole Closing

- Attempt to eliminate tax avoidance via corporate structuring

■ Franchise Tax Changes

- Taxpayers may reduce deferred tax liabilities by corresponding tax assets, but not below zero

Property Tax Changes

■ H.B. 2097, Property Tax Changes

- Allows electronic listing of individual personal property
- Clarifies funding mechanism for combined vehicle registration/property tax system
- County boards of equalization & review have authority to approve late applications for appraisal
- Allows collectors to receive tax receipts for appealed assessments
- Other clarifying changes

Property Tax Changes

- S.B. 1451, Delinquent Property Tax/Inventory/Study
 - Revenue Laws recommendation
 - Relieves seller of personal liability for property tax when property transferred before taxes become delinquent or when transferred before property is annexed and taxes imposed
 - Codifies practice of prorating property taxes when property is sold
- Property Tax/Vehicle Registration
 - Change in effective date

Legislative Studies

■ H.B. 1723, The Studies Act of 2006

■ Section 7, Revenue Laws Study Committee

- Property tax valuation
- Administrative & judicial review of tax cases
- State business taxation
- Sound Management Program for forest land
- Tax refund donation for prostate cancer
- Housing authority tax exemptions
- Tax refund contributions to charitable causes
- Income tax refund contribution election
- Intermodal rail facility
- Sales & income tax reform

Tax Reform & Modernization

- H.B. 1723, The Studies Act of 2006
 - Section 38, Continue Twenty-First Century Revenue System Study Commission
 - Section 47, State and Local Fiscal Modernization Study Commission
- Other reform commissions
 - Emerging Issues Forum
 - Possible foundation-sponsored reform study

Resources

- 2006 Finance Law Changes Publication
www.ncleg.net/LegLibrary
- 2006 Overview: Fiscal & Budgetary Actions
[www.ncleg.net/LegislativePublications/fiscalresearchd /](http://www.ncleg.net/LegislativePublications/fiscalresearchd/)
- Revenue Laws website:
www.ncleg.net/committees/revenuelawsstudy
- Revenue Laws email address: revenuelaws@ncleg.net